

FY 2020 Market Dominant Product Incremental Costs

I. PREFACE

A. Purpose and Content

USPS-FY20-43 provides incremental cost estimates for market dominant products and classes for FY 2020, along with supporting documentation. Consequently, it also provides the inframarginal cost estimates by product necessary to implement the expanded definition of attributable costs adopted by the Commission in Docket No. RM2016-13, Order No. 3641 (December 1, 2016).

B. Predecessor Document

The direct predecessor for this folder in last year's ACR was USPS-FY19-43. In ACR dockets before Order No. 3641, materials regarding incremental costs for competitive products (but not market dominant products) appeared in folder NP10 (e.g., in Docket No. ACR2015, USPS-FY15-NP10). Previously, materials on incremental costs were filed in omnibus rate cases, most recently the testimony of witness Pifer (USPS-T-18) in Docket No. R2006-1.

C. Corresponding Nonpublic Document

The corresponding nonpublic document, presenting incremental cost materials for competitive products is USPS-FY20-NP10, although additional material on incremental costs for competitive NSA products appears in USPS-FY20-NP27.

D. Methodology

USPS-FY20-43 applies essentially the same basic methodology as applied in the FY 2019 ACR with respect to market dominant products in USPS-FY19-43, and with respect to competitive products in USPS-FY19-NP10. That methodology includes the modifications mentioned by the Commission in Order No. 3506 to allow the previously approved group-level incremental cost model to calculate class-level and product-level incremental costs.¹ As was done last year (and all years since the issuance of Order No. 3641), the model from USPS-FY15-NP10 has been modified to produce the class-level and product-level incremental costs, and has been applied to market dominant products in this folder.

The USPS-FY15-NP10 methodology was developed in Proposal 22, Docket No. RM2010-4 (approved by the Commission on January 27, 2010 in Order No. 399). As indicated in Proposal 22, the calculation of incremental costs, including any group specific costs, is based on the methodology presented by witness Bradley

¹ Docket No. RM2016-2, Order No. 3506 (September 9, 2016) at page 60.

and implemented by witness Kay in Docket No. R2000-1.² The methodology was successfully implemented in subsequent rate cases as well, such as Docket No. R2001-1 and Docket No. R2005-1.³

As indicated in Proposal 22, this methodology builds up from cost estimates developed at the cost pool level, and thus can only be applied directly to products for which product-specific data are available at the cost pool level. Proposal 22 (October 23, 2009) at 2-3. Proposal 22 noted that cost pool information is not available for international products (*id.* at 3-4), and therefore the methodology has historically been applied only to domestic products.⁴ Consistent with the current limitations identified in Proposal 22, the best available estimate of the FY 2020 incremental costs for each international market dominant product is simply the sum of the volume variable costs and the product specific costs for that product. Since the public portion of those international costs are already shown in the public CRA in USPS-FY20-1, they are not reproduced here.⁵

Two notable improvements in the incremental cost methodology first introduced in FY 2017 continue to be applied. The first improvement allowed the group of competitive international products to be directly included when incremental costs are estimated for the overall group of all competitive mail products. The second improvement relates to NSA products, and employs a proxy measure to substitute for actual cost-pool level data, using this to provide an estimate of

² See, Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service, Docket No. R2000-1, USPS-T-22; and Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2000-1, USPS-T-23.

³ See Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2001-1, USPS-T-21 and Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2005-1, USPS-T-18.

⁴ The Commission acknowledged these circumstances in Order No. 3641(Docket No. RM2016-13, December 1, 2016) at 6.

⁵ The absence of inframarginal cost estimates for market dominant international mail products might be viewed as more troubling if there were reason to believe that such estimates (if available) might be material, but that is not the case. This conclusion is based on the magnitude of the inframarginal costs obtained when estimating group incremental costs for the entire group of market dominant international mail. As shown in Table 1 on page 6, those results indicate that inframarginal cost estimates for the entire group would appear to be a very small fraction of volume variable costs, somewhere in the neighborhood of 0.2 percent. For individual products within the group, that fraction would be even smaller. Consequently, while it would be ideal to have incremental costs for each individual international product, the current inability to generate such estimates (and thus alternatively to rely simply on the sum of volume variable and product specific costs) does not result in any material understatement of attributable costs for those products.

product-level inframarginal costs. The same proxy procedure is applied to both market dominant (if any) and competitive “product types” that contain domestic NSA products, although only the market dominant calculations (if there were any) would be presented in this folder. The same proxy procedure is also applied to derive separate inframarginal cost estimates for the market dominant and competitive portions of Post Office Box Service and for the Non-Profit approximations that are presented in USPS-FY20-27. The Post Office Box approximations are shown in USPS-FY20-NP10 and the Non-Profit approximations are found in this folder. Further details on these two earlier improvements (which were approved by the Commission on July 20, 2018 in Order No. 4720 in Docket No. RM2018-6) can be found in the Preface to USPS-FY18-43.

The available incremental cost information regarding Market Dominant products is summarized in the Excel file **IC2020Public.ICSummaryRpt.xlsx**, and is also reproduced at the end of this Preface.⁶ The results start with a column (Column 4) showing the product-level and class-level incremental costs generated by the existing model. By necessity, however, this model uses as inputs volume-variable costs *before* any final adjustments. Therefore, additional columns are presented showing the final adjustments, and then adding those final adjustments to the model-based incremental costs. Note that the final adjustment for Post Office Boxes removes the volume variable cost of competitive Post Office Box Services, but the inframarginal cost is for the entirety of Post Office Box Services. Displayed at the end of this document are the inframarginal costs for market dominant Post Office Boxes generated by the cost driver approximation analysis, as well as the inframarginal costs for market dominant NSAs. (The actual calculations of the Post Office Box inframarginal costs, however, are presented in the Special Analyses folder of USPS-FY20-NP10.)

⁶ Incremental costs are presented in some rows containing multiple products (e.g., Total Single-Piece Letters and Cards, Total First-Class). As postal witnesses have repeatedly stressed (see, e.g., the Direct Testimony of Nancy R. Kay, USPS-T-21, Docket No. R2001-1, at page 20), the incremental costs of a group of products will be different from the sum of the incremental costs of the individual products within the group. As she explains in that testimony, this occurs because of how the total amount of the cost driver associated with the volume of the entire group is removed when calculating the aggregate group incremental costs. Readers therefore should not expect that the *incremental* costs shown in rows in this folder presenting results for multiple products will equal the sum of the *incremental* costs shown in the rows for the constituent products aggregated in that row.

Finally, as was done last year, Excel file **IC2020Public.NewAttribCRpt.xlsx** shows attributable and institutional cost at the component level, as directed by the Commission in the FY2017 ACD (March 29, 2018) at page 10.

E. Input/Output

The inputs for the primary calculation of the incremental costs for domestic products are from the FY 2020 CRA Model (Model Files, Cost Matrices, and Reports), USPS-FY20-31, and FY 2020 CRA “B” Workpapers, USPS-FY20-32. This year, there are no inputs for market dominant NSAs to be obtained from USPS-FY20-30.

The outputs are the inframarginal costs used as a component of the attributable costs appearing in the CRA Reports (USPS-FY20-1 and USPS-FY20-NP11), for Non-Profit USPS Marketing Mail in USPS-FY20-27, and for domestic market dominant NSA products (if there were any) in USPS-FY20-30.

II. ORGANIZATION

The Incremental Cost (IC) Model is filed as USPS-FY20-43.zip. The zip file contains four folders with the files needed to use the IC Model:

- Documentation – Reference Files
- Programs – Program Files
- Model – Input and Output Files
- Special Analyses – All files used to estimate the incremental cost for market dominant NSAs and Non-Profit USPS Marketing Mail.

The Documentation folder contains two files. The files in this folder and their functions are as follows:

- ICRunInstructions.doc – Instructional Document
- CostPoolsFY2020Public.xlsx – Input Cost Pool Data (added to FY2020Public.ComboOutputMatrix.xlsx)

The Programs folder contains the two program files:

- IC.Model.xlsm – IC Model run module
- IC.DIM.xlsm – IC Model data input module

The Model folder contains three input files needed to replicate Domestic Market Dominant and International Market Dominant Incremental Cost:

- FY20Public.ComboOutputMatrix.xlsx – Fiscal Year 2020 public CRA OutputMatrix with added international market dominant and costpools.
- IC2020Public.cntl.xlsm – Incremental Cost 2020 control tables
- IC2020Public.PS.xlsx – Incremental Cost 2020 product specific

The Model folder also contains five output files that are a result of the model's run:

- IC2020Public.CRpt.xlsx – IC C (Cost Segments and Components) Report
- IC2020Public.ICSummaryRpt.xlsx – IC Summary Report
- IC2020Public.PSRpt.xlsx – Group Product Specific Report
- IC2020Public.CP.xlsx – Cost Pool calculation workbook
- IC2020Public.IC.xlsx – IC calculation workbook
- IC2020Public.NewAttribCRpt.xlsx – Attributable and institutional cost by component

The Special Analysis folder contains all of the program and model files used in the estimation of incremental cost for market dominant NSAs (if there were any) and the non-NSA portion of the relevant products, and the Non-Profit portion of the relevant products. The NSA and non-NSA portion of market dominant products is used in USPS-FY20-1, market dominant NSA incremental costs (if there are any) are used in USPS-FY20-30, and non-profit incremental costs are used in USPS-FY20-27. The IC.Model.xlsm and IC.DIM.xlsm have been set up with the correct options and mail class list to use for this run.

- IC.Model.xlsm – IC Model run module
- IC.DIM.xlsm – IC Model data input module
- FY20.PublicOutputMatrix_NonProfit.xlsx – Fiscal Year 2020 CRA Output Matrix with development of cost share percentages for Non-Profit
- IC2020Public.cntl.xlsm – Incremental Cost 2020 control tables
- IC2020Public.CP.xlsx – Cost Pool calculation workbook
- IC2020Public.IC.xlsx – IC calculation workbook
- IC2020Public.CRpt.xlsx – IC C (Cost Segments and Components) Report
- IC2020Public.ICSummaryRpt_NonProfit.xlsx – IC Summary Report for market dominant NSA and Non-Profit.

Table 1. IC Summary Report for Market Dominant Products and Total Competitive

| Component Name | | Vol Var / Prod Spec Cost | Group Product Specific | Inframarginal | Incremental Cost | Final Adjustments | Incremental Cost with Final Adjustments |
|--|------------|-------------------------------|---------------------------------|---------------------------|-------------------|--------------------------|---|
| Source/Notes | | USPS-FY20-31 USPS-FY20-NP4 | USPS-FY20-NP10 USPS-FY20-NP2 | Col.4 - (Col. 1 + Col. 2) | | USPS-FY20-31 D Report | Col. 4 + Col. 5 |
| Columns | | (1) | (2) | (3) | (4) | (5) | (6) |
| MARKET DOMINANT PRODUCTS | | | | | | | |
| First-Class Mail | | | | | | | |
| Single Piece Letters | 3 | 4,653,060 | 0 | 172,895 | 4,825,955 | 0 | 4,825,955 |
| Single Piece Cards | 4 | 176,895 | 0 | 1,992 | 178,887 | 0 | 178,887 |
| Total Single Piece Letters and Cards | 5 | 4,829,955 | 0 | 192,141 | 5,022,096 | 0 | 5,022,096 |
| Presort Letters | 8 | 4,696,426 | 0 | 84,580 | 4,781,006 | 0 | 4,781,006 |
| Presort Cards | 9 | 204,378 | 0 | 258 | 204,636 | 0 | 204,636 |
| Total Presort Letters and Cards | 10 | 4,900,804 | 0 | 95,248 | 4,996,052 | 0 | 4,996,052 |
| Flats | 14 | 1,541,609 | 0 | 2,950 | 1,544,559 | 0 | 1,544,559 |
| Total First-Class | 80 | 11,272,368 | 0 | 550,817 | 11,823,186 | 0 | 11,823,186 |
| USPS Marketing Mail | | | | | | | |
| High Density and Saturation Letters | 21 | 617,064 | 0 | 3,777 | 620,842 | -35,963 | 584,878 |
| High Density and Saturation Flats and Parcels | 22 | 1,384,065 | 0 | 16,952 | 1,401,016 | 35,963 | 1,436,980 |
| Every Door Direct Mail Retail | 24 | 38,361 | 0 | 33 | 38,394 | 0 | 38,394 |
| Carrier Route | 23 | 1,388,626 | 0 | 5,505 | 1,394,131 | 0 | 1,394,131 |
| Letters | 25 | 4,645,186 | 0 | 114,278 | 4,759,464 | 0 | 4,759,464 |
| Flats | 26 | 2,118,711 | 0 | 5,043 | 2,123,754 | 0 | 2,123,754 |
| Parcels | 27 | 65,001 | 0 | 9 | 65,009 | 0 | 65,009 |
| Total USPS Marketing Mail | 81 | 10,257,013 | 0 | 526,168 | 10,783,181 | 0 | 10,783,181 |
| Periodicals | | | | | | | |
| In County | 31 | 99,733 | 0 | 31 | 99,764 | 0 | 99,764 |
| Outside County | 32 | 1,693,971 | 0 | 4,185 | 1,698,156 | 0 | 1,698,156 |
| Total Periodicals | 82 | 1,793,704 | 0 | 4,733 | 1,798,437 | 0 | 1,798,437 |
| Package Services | | | | | | | |
| Alaska Bypass | 45 | 21,811 | 0 | 0 | 21,811 | 0 | 21,811 |
| Bound Printed Matter Flats | 42 | 128,255 | 0 | 27 | 128,283 | 0 | 128,283 |
| Bound Printed Matter Parcels | 43 | 307,573 | 0 | 289 | 307,862 | 0 | 307,862 |
| Media and Library Mail | 44 | 439,571 | 0 | 1,004 | 440,575 | 0 | 440,575 |
| Total Package Services | 83 | 897,210 | 0 | 2,189 | 899,400 | 0 | 899,400 |
| U.S. Postal Service | 85 | 335,463 | 0 | 90 | 335,553 | -335,463 | 90 |
| Free Mail | 86 | 34,752 | 0 | 1 | 34,754 | 0 | 34,754 |
| Special Services | | | | | | | |
| Ancillary Services | | | | | | | |
| Certified | 51 | 478,757 | 0 | 6,414 | 485,172 | 0 | 485,172 |
| COD | 52 | 2,974 | 0 | 0 | 2,974 | 0 | 2,974 |
| Insurance | 54 | 32,201 | 0 | 7 | 32,207 | 0 | 32,207 |
| Registered Mail | 55 | 14,481 | 0 | 1 | 14,482 | 0 | 14,482 |
| Stamped Envelopes | 56 | 8,442 | 0 | 7 | 8,450 | 1,560 | 10,010 |
| Stamped Cards | 57 | 175 | 0 | 0 | 175 | 0 | 175 |
| Other Ancillary Services | 58 | 265,129 | 0 | 3,101 | 268,230 | 0 | 268,230 |
| Address Management Services | 61 | 6,209 | 0 | 0 | 6,209 | -679 | 5,531 |
| Caller Service | 62 | 28,122 | 0 | 33 | 28,154 | 0 | 28,154 |
| Money Orders | 73 | 155,130 | 0 | 1,817 | 156,947 | 0 | 156,947 |
| Post Office Box Service | 74 | 324,431 | 0 | 411 | 324,842 | -194,392 | 130,450 |
| Total Domestic Market Dominant Services | 91 | 1,316,052 | 0 | 31,877 | 1,347,929 | -179,961 | 1,167,968 |
| International Market Dominant | 159 | 413,505 | | 972 | 414,477 | | 414,477 |
| Total Domestic Competitive Attributable Costs | 192 | 16,747,500 | 60,371 | 624,767 | 17,432,637 | 509,256 | 17,941,894 |
| International Competitive | 179 | 1,451,295 | | 326 | 1,451,621 | | 1,451,621 |
| Total Competitive | 197 | 18,198,795 | 60,371 | 658,233 | 18,917,398 | 509,256 | 19,426,654 |

In FY 2020 there were no market dominant NSAs, and therefore no NSA results are summarized in the table below. The inframarginal costs for Non-Profit, used in folder USPS-FY20-27, however, are shown in this table.

Table 2. IC Summary Report for USPS Marketing Mail Non-Profit

| Component Name | | Vol Var / Prod Spec Cost | Inframarginal | Incremental Cost |
|--|-----|--------------------------|----------------|------------------|
| Source/Notes | | USPS-FY20-31 | Col.3 - Col. 1 | |
| | | USPS-FY20-27, 30 | | |
| Columns | | (1) | (2) | (3) |
| USPS MARKETING MAIL NON-PROFIT | | | | |
| Non-Profit High Density and Saturation Letters | 134 | 49,140 | 23 | 49,163 |
| Non-Profit High Density and Saturation Flats and Parcels | 135 | 89,391 | 67 | 89,459 |
| Non-Profit Carrier Route | 133 | 123,155 | 42 | 123,197 |
| Non-Profit Letters | 130 | 1,100,458 | 5,777 | 1,106,235 |
| Non-Profit Flats | 131 | 657,416 | 466 | 657,882 |
| Non-Profit Parcels | 132 | 31,066 | 2 | 31,068 |

Table 3. IC Summary Report for Market Dominant Post Office Box Services

| Component Name | | Vol Var / Prod Spec Cost | Inframarginal | Final Adjustment | Incremental Cost |
|------------------------|-----|--------------------------|-----------------|------------------|------------------|
| Source/Notes | | USPS-FY20-NP13 | Col, 3 - Col. 1 | | |
| | | USPS-FY20-NP26,NP27 | | | |
| Columns | | (1) | (2) | (3) | (4) |
| PO BOXES | | | | | |
| Market Dominant PO Box | 135 | 130,039 | 65 | | 130,104 |